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April 27, 1999

By Fax/Original by Mail

David Guzy, Chief
Rules and Procedures Staff
Minerals Management Service
P.O. Box 25165 MS 3021
Denver, Colorado 80225

Re: Proposed Oil Valuation Rules

Dear Mr. Guzy:

For the reasons stated in its prior comments and during the public workshops, it is the position of the State Controller's Office that the Minerals Management Service should move forward to implement its proposed rule for oil valuation, with the appropriate modifications as detailed in SCO's prior comments, e.g., the safety net proposal.

Nothing in the most recent workshops was said by the industry representatives that would cause SCO to alter its views. In summary:

- (a) Legal principles surrounding joint ventures and limited partnerships do not support industry's position that these entities should fall within the corporate control percentages under existing rules. Moreover, the ownership control percentages should remain as one of many factors looked at to determine whether a contract is or is not arm's length. The rulemaking should not be delayed because of industry's request for a list of rebuttal factors, which list, if it is to go forward, should be illustrative not exhaustive.
- (b) SCO agrees with MMS's position that the decision to issue advance valuation decisions should remain discretionary. Any such decision should also apply only to the company requesting the decision.
- (c) SCO continues to oppose any allowances for marketing. Industry's assertions are not pertinent to a market value lease, and, if adopted, would transform federal leases into

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net profits leases. In determining value internally, companies make no adjustment for marketing to determine oil value.

(d) Industry has failed to present either evidence or convincing argument for modification of MMS's transportation/actual costs regulations. The BBB bond rate is already a generous rate of return, which over time will provide a reasonable return on both debt and equity.

(e) A comparable sales approach simply does not address the problems associated with undervalued field prices. In fact, industry's proposed approach appears to be designed to allow major integrated companies to take advantage of MMS's exclusion of the true value of oil exchanged from the arm's length definition. This would appear to be particularly true given the major companies' active opposition to use the gross proceeds/minimum value rule.

(f) There is no rational reason why private parties, including oil and gas companies, should benefit from the protection extended by the duty to market while the public should not. It is clear that industry wants to roll back or eliminate the duty to market principle for federal purposes. In fact, their proposal at the close of the second day of the DC workshop indicates that, at the very least, they want (1) to increase the burden on the federal government to establish breach (e.g. fraud standard), or (2) replace well understood common law standards (e.g., prudent operation) with uncertain standards (e.g., "illegalities") that will foster litigation. SCO urges that MMS adopt its recommended definition, which was designed after a review of the extant case authorities.

After reviewing the comments and expressed concerns of other State entities, SCO urges MMS to reconsider distinguishing between independents and major companies -- at the very least for purposes of going forward now with a rule applicable to majors -- and recommends that it adopt a flexible approach that considers both volumes produced in a jurisdiction (e.g., comments submitted by Oklahoma) and degree of downstream affiliation/integration.

Respectfully submitted,



Lee Ellen Helffich

On behalf of the
California State Controller's Office